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DIRECTORATE OF INTELLIGENCE

Intelligence Memorandum

Saudi Arabia Enters Eastern European Oil Markets

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
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INTELLIGENCE MEMORANDUM

Saudi Arabia Enters Eastern European Oil Markets

Summary

The recently concluded barter arrangement between Saudi Arabia and Rumania involving the exchange of crude oil for industrial goods appears to be economically beneficial to both countries, providing the Suez Canal is reopened. The Saudi Arabian government has access to ample oil to meet the projected sale, and the type of equipment that Rumania will provide is compatible with Saudi needs. Price terms have not been announced but are probably advantageous to Saudi Arabia. Rumania needs to supplement its nearly stagnant output of crude oil to support growing exports of refined products, especially to Western Europe, where it earns badly needed hard currency. If the Suez remains closed, however, transport costs may be too high to make the exchange worthwhile.

The Saudi-Rumanian deal is the latest of a series of agreements and probes involving prospective sales of Middle East oil to Eastern European Communist countries. The Communist market for Middle East oil is growing, but, at least until the mid-1970's, will be too small to absorb all of the oil that Middle East governments could market on their own account.

Note: This memorandum was produced solely by CIA. It was prepared by the Office of Economic Research and was coordinated with the Office of Current Intelligence.

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Introduction

1. On 30 April 1968 the Saudi Arabian government announced final approval for an oil-for-goods barter agreement with Rumania. The agreement provides for delivery to Rumania of 9 million tons* of crude oil over a four-year period, beginning in 1968, in exchange for Rumanian goods and industrial equipment valued at an estimated $100 million. The exchange may be raised by 3 million tons of oil in the last two years of the agreement. Deliveries of crude oil, f.o.b. Ras Tanura, are planned to begin in June 1968, but only about 1 million tons is scheduled to be shipped this year. The Rumanians will provide industrial equipment for oil refineries, petrochemical facilities, and mining installations and possibly will supply some agricultural machinery. The quantities and exact mix of Rumanian goods are to be determined by future negotiations and will depend largely on Saudi Arabian needs and the ability in some instances to make trilateral arrangements for some goods.

2. The oil to be sold to Rumania will be "royalty oil" made available to the Saudi government by the oil companies in lieu of cash payments and will be supplied to the Saudi Arabian General Petroleum and Mineral Organization (Petromin) by the Arabian-American Oil Company (Aramco), the major concession holder in Saudi Arabia. In mid-February 1967 the Saudi government and Aramco agreed that Aramco would supply crude oil for Saudi Arabian barter sales to five Eastern European Communist countries (Rumania, Bulgaria, Hungary, Czechoslovakia, and Poland).** The oil sold by Saudi Arabia to these countries is not to be resold in crude form to any third countries where it could compete with Aramco sales.

Rumania's Need for Oil Imports

3. Rumania will import crude oil in order to increase its exports of refined products. Crude

* *Unless otherwise indicated, all tonnages are metric tons.*

** *The Saudi-Aramco agreement is similar to the Iran-Consortium agreement of 1966.*

oil production in Rumania at present is about 13 million tons per year and is expected to increase by only about 1 million tons by 1970 and 2 million tons by 1975. Refinery capacity, on the other hand, is expected to rise from the present 14 million tons to between 17 million and 18 million tons by 1970 and between 22 million and 23 million tons by 1975. If expansion meets plan goals, Rumanian refineries will therefore be able to process about 3 million tons of imported crude oil a year by 1970 and 7 million tons a year by 1975. The agreement with Saudi Arabia, together with an earlier agreement with Iran,* would provide about as much imported oil through 1970 as Rumanian refineries would be capable of processing. Rumania will export most of the products refined from the Saudi crude oil. About 38 percent of Rumanian exports of oil products have been going to Western Europe, and about 12 percent to other Free World countries. Most of the remainder goes to the USSR and Eastern Europe. Rumania imports no oil from the USSR and apparently does not plan to do so.

Advantages of the Deal

4. Both the Saudis and the Rumanians could gain economically from this barter transaction. Saudi Arabia can obtain royalty oil instead of cash payment for its share of oil receipts from Aramco at an estimated price of $0.83 per barrel. Prices of oil and Rumanian goods under the agreement are unknown. If these goods are exchanged at world market prices,** Saudi Arabia would receive the equivalent of $1.40 per barrel in Rumanian goods, a gain of up to $0.60 a barrel over the cash royalty payment. Saudi Arabia, however, would be forgoing convertible foreign exchange by trading royalty oil to Rumania. Rumania, on the other hand, would obtain oil at barter terms for refining into products that would be destined partly for sale in hard currency markets. The Rumanian goods provided in exchange are difficult to sell for hard currency. Some of

* *Some 3.5 million tons are scheduled for delivery from Iran during 1969 and 1970 under a three-year goods-for-oil barter agreement signed in early 1967.*
** *The price of Saudi Arabian oil is posted at $1.80 a barrel f.o.b. Ras Tanura less discounts of about $0.40.*

them, particularly petroleum refining equipment, are of reasonably good quality, although not particularly modern.

5. For the longer run, the Saudis' move into the international petroleum market is compatible with their efforts to become more active in management of domestic industrial development and their own international economic affairs. [redacted] 25X1

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Transportation Problems

6. The main direct route from Persian Gulf ports to Rumania via the Suez Canal is closed, and the high cost of the principal alternative route around the Cape of Good Hope may militate against implementation of the agreement. Iran, which also has a barter agreement with Rumania for the exchange of oil for industrial goods, has made no oil shipments thus far. Presumably, these shipments have been held up because of the high cost of shipment around the Cape of Good Hope. Shipments via Suez from the Persian Gulf to Laverna (France), for example, cost about 43¢ a barrel, while shipments via the Cape of Good Hope in medium-size tankers cost some 62.5¢ a barrel. Movement of oil from Saudi Arabia to Rumania cannot be done in the relatively low cost supertankers because Rumanian ports will be unable to accommodate ships larger than 50,000 deadweight tons in the next few years. Use of the proposed Israeli pipeline from Eilat to the Mediterranean Sea is very unlikely, because of Arab-Israeli hostility.

Possibility of Other Middle Eastern Countries Selling Oil in Eastern Europe

7. The Saudi Arabian move is part of a larger picture of rising interest by Middle Eastern states in selling their own oil and diversifying trading partners. Before the current Saudi-Rumanian agreement, most Rumanian interest had been centered on Iran. In addition to the barter arrangement of 1967 for 3.5 million tons, several other deals have been discussed over the past several years. Iran has been negotiating with Czechoslovakia for similar oil-for-industrial goods agreements; implementation of these agreements probably would involve shipments through the Yugoslavian pipeline from Bakar to Pancevo (now under construction) which may be connected to a proposed line from Vukovar across Hungary to Czechoslovakia. Other Middle Eastern countries showing interest in potential sales in Eastern Europe include Kuwait (currently discussing possible sales with both Bulgaria and Rumania), Syria, and possibly Iraq.

Limitations of Eastern European Markets in Absorbing Barter Oil

8. The Eastern European Communist countries are a fast-growing but small market for Middle Eastern oil. Apparent consumption of petroleum products in Eastern Europe rose at an average rate of almost 13 percent during 1963-66, and an annual growth of about 10 percent can be expected through the mid-1970's. A large refinery construction program has been under way since 1960 in all of the Eastern European Communist countries. At least one large refinery-petrochemical complex has been built and is still undergoing expansion in each country. Total refining capacity is expected to increase from the present 40 million to 43 million tons a year to between 60 million and 65 million tons by 1970 and to between 96 million and 100 million tons by 1975. The USSR probably will continue to supply the predominant part of Eastern Europe's crude oil needs (except for Rumania's) for many years. There will be adequate Soviet oil supplies and sufficient pipeline capacity for this purpose. Even so from non-Communist sources the Eastern European countries probably will import about 5 million to 7 million tons of crude oil in 1970 and

16 million to 20 million tons in the mid-1970's. Eastern European demand for non-Communist oil in the mid-1970's and beyond is highly uncertain. It will depend on pipeline construction to the USSR, Soviet oil export policy, political developments, and how anxious the Eastern European countries will be to reduce their economic dependence on the USSR. At best, however, the Eastern European market could not absorb all of the potential supply available to the various Middle Eastern governments for direct sales, and considerable competition may develop among these states for the Eastern European market. For example, Iran by itself is estimated to have the capacity to satisfy all of these markets.